

Message Text

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ACTION EA-09

INFO OCT-01 IO-11 ISO-00 SP-02 AID-05 EB-07 NSC-05 CIEP-01

TRSE-00 SS-15 STR-04 OMB-01 CEA-01 CIAE-00 COME-00

FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 /088 W

----- 122840

R 160443Z JAN 76

FM AMEMBASSY SEOUL

TO SECSTATE WASHDC 5020

INFO CINCPAC

USDEL MTN GENEVA

AMEMBASSY TAIPEI

AMEMBASSY TOKYO

C O N F I D E N T I A L SECTION 1 OF 2 SEOUL 0375

CINCPAC FOR POLAD, PASS TO AMBASSADOR SNEIDER

E.O. 11652: GDS

TAGS: EGEN, EFIN, MASS, MPOL, MTN, KS

SUBJECT: ECONOMIC RECOVERY IN 1975 HERALDS A GOOD 1976

SUMMARY: AN EXCELLENT SECOND HALF PERFORMANCE HAS MEASURABLY IMPROVED KOREA'S BALANCE OF PAYMENTS SITUATION BOTH IN TERMS OF THE ACTUAL 1975 RESULTS AND THE 1976 OUTLOOK. THE RISE IN EXPORT VOLUME WAS PARTICULARLY STRONG OVER THE FINAL SIX MONTHS AND WAS INSTRUMENTAL IN PRODUCING FURTHER GROWTH IN REAL GNP PRELIMINARILY ESTIMATED AT 7.4 PERCENT FOR 1975 AS COMPARED TO 8.6 PERCENT FOR 1974. POLICIES AIMED AT CONSOLIDATING THE SECOND HALF 1975 B.O.P. IMPROVEMENT AND REDUCING INFLATION ARE TO BE GIVEN TOP PRIORITY IN 1976 COEQUAL WITH GROWTH. DESPITE A POSTURE OF GENERAL RESTRAINT, ROKG PLANNERS ARE COUNTING ON FURTHER EXPORT EXPANSION TO PACE ADDITIONAL REAL GROWTH OF 7.0 PERCENT IN THE YEAR AHEAD. THE MAJOR UNCERTAINTY IN THIS OUTLOOK CONCERNS

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THE STILL PENDING DECISIONS ON THE MAGNITUDE AND TIMING

OF THE FORCES IMPROVEMENT PLAN (FIP) AND THE MANNER IN WHICH IT IS TO BE FINANCED.
END SUMMARY

1. THIS MESSAGE IS THE FIRST OF THREE. IT HIGHLIGHTS THE PROSPECTS FOR THE KOREAN ECONOMY IN 1976 AGAINST THE EXPERIENCE OF THE LAST TWO YEARS. THE SECOND MESSAGE PRESENTS A MORE DETAILED ACCOUNT OF INTERNAL ECONOMIC DEVELOPMENTS IN 1975 AND THE THIRD, OF EXTERNAL DEVELOPMENTS.

2. KOREA'S B.O.P. DEFICIT ON CURRENT ACCOUNT, EXCLUDING MAJOR INCREMENTAL DEFENSE IMPORTS, IS EXPECTED TO NARROW TO ABOUT \$1.5 BILLION IN 1976 FROM AN ESTIMATED 1975 DEFICIT OF \$1.9 BILLION AND THE 1974 "OIL SHOCK" DEFICIT OF \$2.0 BILLION. ROKG FORECASTS SCHEDULED TO BE RELEASED LATER THIS MONTH ESTIMATE THAT 1976 EXPORTS, CARRYING FORWARD THE MOMENTUM ACHIEVED OVER THE LATTER HALF OF 1975, WILL RISE BY 28 PERCENT TO \$6,500 MILLION. WITH CONTINUED IMPORT RESTRAINT, THE TRADE DEFICIT IS PROJECTED TO DECLINE TO ABOUT \$900 MILLION COMPARED TO \$1.4 TO \$1.5 BILLION IN 1975 AND \$1.9 BILLION IN 1974. AN ANTICIPATED DEFICIT OF \$557 MILLION IN NET SERVICES AND TRANSFERS WILL COMPRISE THE REMAINDER OF THE 1976 CURRENT ACCOUNT DEFICIT.

3. ELIMINATION OF THE NEED FOR ADDITIONAL NET SHORT-TERM BORROWING, WHICH IN ANY CASE PROBABLY CANNOT BE EXPANDED SIGNIFICANTLY, IS A KEY POLICY GOAL FOR 1976. TO ACHIEVE THIS TARGET, KOREA WILL REQUIRE AN INCREASE OF 14 PERCENT TO \$2,150 MILLION IN GROSS LONG/MEDIUM-TERM CAPITAL INFLOWS (INCLUDING IMF CREDITS AND BANK LOANS) TO FINANCE THE FORECASTED CURRENT ACCOUNT DEFICIT, THE AMORTIZATION ON CURRENT DEBT AND A MODEST INCREASE OF \$100 MILLION (TO TOTAL OF \$1,600 MILLION) FOR GROSS FOREIGN EXCHANGE RESERVES.

4. IN ADDITION TO THE B.O.P. TARGETS, THE ROKG IS SEEKING A REDUCTION IN INFLATION IN 1976 TO 15 PERCENT (ON A GNP DEFLATOR BASIS) AS COMPARED TO 24.4 PERCENT
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IN 1975. TO ACHIEVE THIS GOAL, THE ROKG PLANS: (A) TO REDUCE THE OVERALL FISCAL DEFICIT THROUGH ELIMINATION OF THE FERTILIZER SUBSIDY AND THE OPERATING DEFICIT IN THE GRAIN MANAGEMENT FUND; (B) TO RESTRICT GROWTH IN THE MONEY SUPPLY TO 20 PERCENT AS COMPARED TO 25.6 PERCENT IN 1975; (C) TO LIMIT THE INCREASE IN DOMESTIC CREDIT TO 30 PERCENT AS CONTRASTED WITH NEARLY 54 PERCENT IN 1974 AND 32.5 PERCENT IN 1975; AND (D) TO PREVENT

UNWARRANTED PRICE INCREASES THROUGH STRENGTHENED
ADMINISTRATIVE CONTROLS.

5. COMMENT: BOTH THE B.O.P. AND INFLATION TARGETS FOR 1976
ARE COMMENDABLE, IF SOMEWHAT AMBITIOUS, POLICY GOALS IN
CURRENT CIRCUMSTANCES. IT IS THE PROFESSED INTENT OF ROKG
POLICY MAKERS TO SACRIFICE THE 7 PERCENT GROWTH TARGET IF
NECESSARY TO ACHIEVE THESE PRIORITY GOALS, BUT THEY DO
NOT EXPECT TO HAVE TO AND REALLY BELIEVE THEY WILL DO BETTER
THAN THE TARGET.

6. DESPITE THE REMARKABLE SECOND HALF 1975 PERFORMANCE,
KOREA'S PRESENT B.O.P. POSITION REMAINS VULNERABLE TO

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FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03 LAB-04

SIL-01 /088 W

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C O N F I D E N T I A L SECTION 2 OF 2 SEOUL 0375

CINCPAC FOR POLAD, PASS TO AMBASSADOR SNEIDER

A DOWNTURN IN WORLD TRADE CHIEFLY DUE TO THE LARGE OVERHANG OF
SHORT-TERM DEBT ACCUMULATED OVER THE PAST TWO YEARS. IF DEFENSE
IMPORT REQUIREMENTS ARE SET ASIDE, THE CURRENT ACCOUNT PROJECTION
FOR 1976 APPEARS REALISTIC, BUT MUSTERING SUFFICIENT LONG AND
MEDIUM-TERM FINANCING TO COVER EVEN THIS REDUCED GAP WILL NOT BE

EASY. AT A MINIMUM, IT WILL REQUIRE CONTINUED HIGH LEVELS OF RECEIPTS OR OTHER SUPPORT FROM SUCH SOURCES AS PL-480, CCC, IMF, ADB, IBRD, EX-IM AND OPIC. THE DOMESTIC FISCAL ASPECTS OF THE ENLARGED DEFENSE BURDEN, IN TURN, COMPOUND THE TASK OF REDUCING THE RATE OF DOMESTIC INFLATION.

7. ACHIEVEMENT OF THE 1976 B.O.P. GOALS WOULD SERVE AS A PSYCHOLOGICALLY IMPORTANT DEMONSTRATION TO FOREIGN FINANCERS AND INVESTORS OF KOREA'S ABILITY TO ADJUST ITS FOREIGN BORROWING TO CHANGING CIRCUMSTANCES IN THE INTERNATIONAL ECONOMY. SIMULTANEOUS SUCCESS IN CURTAILING INFLATION, RAISING DOMESTIC SAVINGS AND INCREASING THE TAX BURDEN ON ITS POPULATION WOULD REINFORCE KOREA'S CREDITWORTHINESS IN THE EYES OF LENDERS, BOTH PUBLIC AND CONFIDENTIAL

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PRIVATE. ASSUMING THAT A BROAD UPTURN IN THE GENERAL WORLD ECONOMY IS FINALLY UNDERWAY, KOREA CAN LOOK FORWARD TO RETIRING SOME SHORT-TERM DEBT AND RESTORING ITS NET FOREIGN ASSET POSITION BEGINNING WITH 1977 AND TO ONCE AGAIN ACHIEVING "TAKE-OFF" WHERE SUSTAINED INVESTMENT AND GROWTH FINANCED LARGELY FROM DOMESTIC RESOURCES WOULD, THOUGH SLOWER, BE A REAL OPTION.

8. THE PROSPECTS FOR ACCOMPLISHING THESE TASKS, PARTICULARLY AS FAR AS THE B.O.P. SITUATION IS CONCERNED, HINGE HEAVILY ON STILL PENDING ROKG DECISIONS ON THE MAGNITUDE AND TIMING OF ITS DEFENSE IMPROVEMENT EFFORT. WHILE ROKG PLANNERS CONTEND THAT SOME ALLOWANCE HAS BEEN MADE IN THE IMPORT ESTIMATE FOR INCREASED DEFENSE REQUIREMENTS, WE SEE LITTLE MARGIN FOR THIS. THE MANNER IN WHICH THE ADDITIONAL IMPORT BURDEN IMPINGES ON BALANCE OF PAYMENTS RESULTS AND INDIRECTLY ON THE GROWTH TARGET IN 1976, DEPENDS, OF COURSE, ON THE EXTENT TO WHICH IT IS COVERED BY FMS CREDITS AND GUARANTEES. THE PORTION NOT FUNDED BY A RELATED INCREASE IN LONG-TERM FINANCING WILL EITHER HAVE TO BE COVERED BY A NET EXPANSION OF SHORT-TERM DEBT OR ALTERNATIVELY BE ACCOMMODATED AT THE SACRIFICE OF OTHER IMPORTS.
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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: DATA, BALANCE OF PAYMENTS, ECONOMIC PROGRAMS
Control Number: n/a
Copy: SINGLE
Draft Date: 16 JAN 1976
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: izenbei0
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1976SEOUL00375
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Film Number: D760016-0605
From: SEOUL
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1976/newtext/t19760149/aaaabroy.tel
Line Count: 209
Locator: TEXT ON-LINE, ON MICROFILM
Office: ACTION EA
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: izenbei0
Review Comment: n/a
Review Content Flags:
Review Date: 06 MAY 2004
Review Event:
Review Exemptions: n/a
Review History: RELEASED <06 MAY 2004 by SmithRJ>; APPROVED <22 SEP 2004 by izenbei0>
Review Markings:

Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
04 MAY 2006

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: ECONOMIC RECOVERY IN 1975 HERALDS A GOOD 1976 SUMMARY: AN EXCELLENT SECOND HALF PERFORMANCE HAS
TAGS: EGEN, EFIN, MASS, MPOL, KS, MTN
To: STATE
Type: TE
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 04 MAY 2006